



**Waller Marine
2011 Research Credit
Engagement Report**

III. METHODOLOGY

A. Qualification approach

1. Overall approach

The 2011 Research and Experimentation ("R&E") Study covered the tax years ending 2/28/11 and 2/28/12. EY computed the 2011 and 2010 research credits under section 41 using the General Credit ("GC") method. The scope of services included the identification of eligible qualified research expenses (QREs) for the tax years ending 2/28/11 and 2/28/12. The historic base period (1984-1988) was established for Waller Marine, and included the Polar Energy subsidiary company.

EY documented the respective 2/28/12 QREs for the 2011 credit computation and to be used in the future years as part of the Alternative Simplified Credit ("ASC") base period QREs. This activity included calculating a research credit with enough detail to allow a selection of the ASC or regular credit in future tax years and identifying project documentation so it can be preserved.

The project team conducted interviews with Waller Marine President David Waller, Vice President Anthony Waller, Engineering Vice President Stephen McKillop, Chief Financial Officer Douglas Hanson, Chief General Counsel Taylor Norton, and various other involved personnel to determine whether certain projects contained qualified research expenditures. We reviewed costing information by project by person, and also reviewed relevant contracts and other project documentation in conjunction with our review of QRE amounts. We then created a summary costing workbook to determine qualified wages and contract expenses for the qualified projects.

2. Validation process

Two primary types of information were requested and received:

- i. Employee Costing information: EY sent a data request to request the gross earnings by employee for the projects conducted in 2010 and 2011. Doug Hanson, Chief Financial Officer, provided this information for Waller Marine.
- ii. Project Detail by employee role: EY sent a data request to Doug Hanson to request project detail by employee role (direct support, direct supervision, or engineering) for 1984 - 1988 and 2010 - 2011.

The raw data was analyzed to identify total project costs and total engineering costs charged to each project. The data was then subtotaled by the project number to determine total engineering expenses by project.

3. Detailed qualification process

A pre-interview email was sent to the Waller Marine individuals listed above. The pre-interview email included the following attachments:

- Example Project Survey (Appendix 1)



- R&E Flow Chart which describes how developmental activities may qualify for the Research Tax Credit (Appendix 2)
- Qualified Activities PowerPoint which describes different scenarios of qualified activities for the Research tax Credit (Appendix 3)

In addition, EY researched for patents and projects from Waller Marine during both the base period and 2007-2011 time frames. We visited the Waller Marine team inquiring about the projects we had identified in our preliminary research as well as any projects that we may not have discovered in our research.

The aim of the interviews was three-fold: (1) to gather facts so that EY could make a determination as to whether or not their activities and related expenses should be deemed qualified; (2) to determine what contemporaneous documentation was available and (3) to update or complete the survey with the project-specific facts obtained during the interview.

After the interview was complete, EY was able to determine qualifying projects for these time periods. Additionally, EY had enough information to seek further information about qualified expenses and qualifying employee time.

4. Funding

During the fact gathering process with the various client personnel, they identified the clients, subcontractors, and relevant phases associated with the projects. These clients have either been paid by Waller Marine based on a Lump Sum or Not to Exceed contract. Generally, when the contractors were paid a lump sum fee to perform services, the risk was borne by Waller Marine and Waller Marine maintained the right to intellectual property developed as a result of such task performed. In these instances, the cost incurred by Waller Marine on activities is considered qualified. Any sub-contractor costs identified that were conducted by the sub-contractor on Waller Marine's behalf are also included in the qualified research expenditures. A contract review was performed for each qualified project to confirm the funding status of the contract.

5. Identification of projects / department / employees

In reviewing Waller Marine's tax returns, we noted a brother-sister corporate relationship between Waller Marine and Polar Energy. We addressed this relationship by requesting information for Polar Energy for the same time periods covered for Waller Marine. Waller Marine President David Waller confirmed no major qualified research projects for Polar Energy during these time frames.

6. Interview process

Chief Financial Officer Douglas Hanson and Chief General Counsel Taylor Norton were asked via post-interview emails to provide the basis on which Waller Marine was performing work for their clients (payment terms). They were also asked to provide the names of employees that worked on activities considered qualified along with an estimation of the amount of hours spent during a specific year on these activities. General Counsel Taylor Norton provided EY with the actual contract between Waller Marine and the client. In a number of instances the contract referred to the actual Purchase Order ("PO") for the terms of the fee structure. Generally the warranties provided by the contractor, the clause on intellectual property rights as well as the termination clauses could be obtained from the contract.



Once it had been determined whether the appropriate clauses within the agreement/contract with the client passed the risks back to Waller Marine, the applicable costs to be included in the determination for qualified research expenditures were captured.

7. How the qualified research activities were documented

As noted above, a project survey was sent to Anthony Waller and Stephen McKillop before the interview with the Waller Marine chief officers took place. Once the interview took place, the surveys were further populated with any discovered relevant facts. The interview notes were incorporated into the surveys.

Documents were requested to support the qualifying activities discussed in the interview. EY incorporated the discovered facts and applied them to the relevant costs in the Final Determination workbooks.

8. Substantiation

EY requested documentation after its meeting interview with the Waller Marine chief officers to support the qualified activities discussed. Chief Financial Officer Douglas Hanson and Engineering Vice President Stephen McKillop sent the following information after our interview:

- Architectural sketches of project designs
- Engineering studies and models on key components (hydraulic jacks, plinth vibration controls, concrete inertia base, etc.,)
- Patents related to project

9. Qualified supply expenses

Supply expenses for the projects were received from Douglas Hanson, Waller Marine Chief Financial Officer, in excel spreadsheet format containing Job ID, General Ledger Account ID, Transaction Date, Vendor ID, Transaction Description, and Net Debit/Credit amount. Expenses were listed by project.

We requested purchase orders for the supplies equaling to 80% of the project costs to qualify the supplies.

10. Qualified contract research expenses

Contract research expenses for the projects was received from Douglas Hanson, Waller Marine Chief Financial Officer, in excel spreadsheet format containing Job ID, General Ledger Account ID, Transaction Date, Vendor ID, Transaction Description, and Net Debit/Credit amount. Expenses were listed by project. Additionally, notes were provided about specific vendors to help qualify amounts; for example, vendors that were tagged as being outside of the United States were excluded from qualified contract research amounts.

After reviewing the lists by their General Ledger Account ID and Transaction Description, we requested contracts for the vendors that comprised 80% of the dollar values for each project. We reviewed the contracts to qualify whether the amounts would qualify as contract research.



B. Quantification approach

1. Summary of credits and use of EY Research Credit Calculator

Waller Marine's R&E credits were calculated in accordance with all the relevant rules in IRC Section 41 utilizing the EY Research Credit Calculator. We calculated a credit of \$6,565,397 for the tax year ending 2/11 and \$6,774,142 for the tax year ending 2/12.

2. Method

EY used the general credit to compute the credits for 2010 and 2011.

3. Section 280C(c) election

I.R.C. §280C(c)(3) allows the taxpayer to elect a reduced credit amount thereby eliminating the requirement to deduct qualified research expenditures claimed for the R&D Tax Credit. This election can only be made on a timely return. For the tax year ending 2/11, the client did not file this election on a timely filed return. Therefore specific adjustments will need to be made for the purposes of capturing the credit for that tax year. For the tax year ending 2/12, we calculated the reduce credit and the client should elect this reduced credit on their timely filed return.

4. Controlled group computation

Waller Marine is part of a controlled brother-sister group along with Polar Energy, Inc. We requested documentation for Polar Energy for the same periods we requested information for Waller Marine and included this information in our credit calculations.

5. Base period computation

To compute the appropriate base period, we analyzed all the acquisition and disposition information and loaded relevant QRE data into the EY R&D calculator. The calculator is an Access database that accurately accounts for acquisition and disposition information in calculating the base period. We incorporated the results of this analysis into our calculations.

During the initial credit calculation for the return, we included data for Polar Energy, Inc., which was created by Waller Marine in 1986, with the Waller Marine population for the base period.

6. Consistency

Qualified Research Expenditures ("QREs") taken into account for computing the general credit base period must be consistent with the determination of QREs for the credit year. EY confirmed that the treatment of QREs was consistent both in the credit year (2011) and in the base years (1984-1988).

7. Approach for quantifying qualified wages

The qualified wages for each project were determined based on the technical interview and quantitatively documented by the Chief Financial Officer, Douglas Hanson, identifying the individuals by name that participated in the qualified activities for each qualified project, and



also identifying the individuals by name that participated in non-qualified activities outside of the country. The CFO also classified individuals by function (direct supervision, direct support, or engineering) for each project for years 2010 - 2011. The CFO additionally provided the Box 1 W-2 Wage detail. If an employee spent 80% or more of his total working hours on qualified activities, then 100% of the employee's wage was captured as qualified wage.

8. Approach for quantifying supplies

The qualified supplies for each project were also determined based on the technical interview and quantitatively documented by the Chief Financial Officer, Douglas Hanson. Qualified supply purchase order document details were requested from either Douglas Hanson or Taylor Norton.

The qualified supplies were included in full, to the extent that they were verified as supplies directly related to the projects in hand.

9. Approach for quantifying contract research expenses

Qualified vendor purchase order document details were requested from the applicable project manager. The related contracts were requested from either Douglas Hanson or Taylor Norton. The contracts were reviewed for payment terms, intellectual property rights, warranties provided and contract termination clauses.

The qualified contract research expenses were multiplied by the qualifying percentage and were then multiplied by an additional 65% as per §41(b)(3)(A).

C. State credits

EY did not calculate any state related credits.